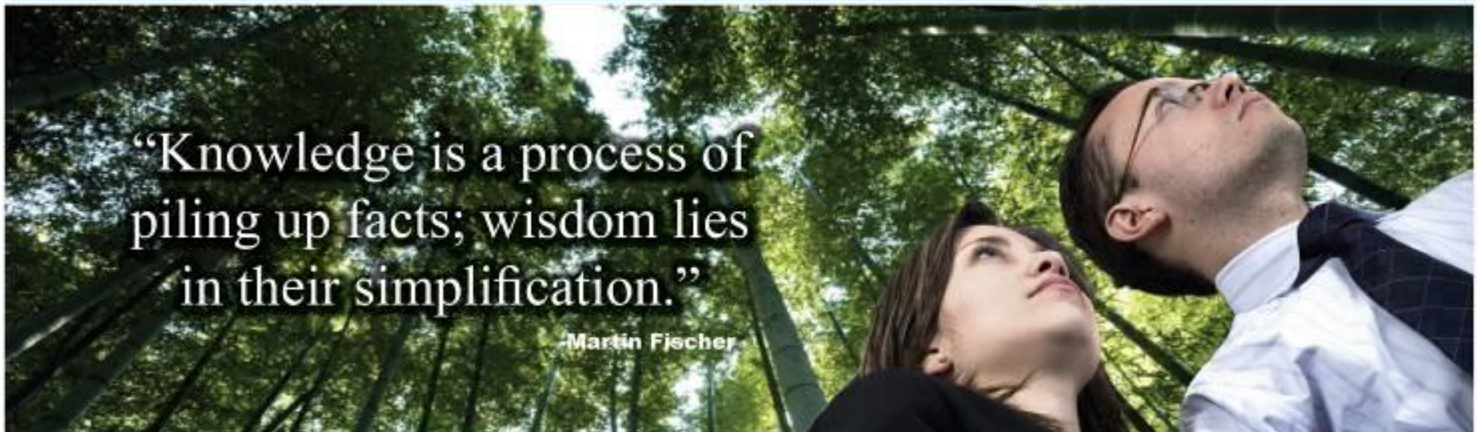
Benefits and Employment Briefing

Garner
Insurance Services



A quarterly newsletter about employee benefits and current issues

Fourth Quarter 2009

RETIREES PREVAIL IN CLAIM FOR VESTED HEALTH BENEFITS

Unlike pension benefits, ERISA does not ordinarily require any vesting of welfare benefits.

[Continued on page 2](#)

CONVERTING UNUSED LEAVE TO RETIREMENT PLAN CONTRIBUTIONS

In September of this year, the IRS issued official guidance on how employers may convert unused leave under a bona fide sick leave, vacation leave, or paid-time-off ("PTO") program into contributions to a qualified, defined contribution plan (such as a profit sharing or 401(k) plan).

[Continued on page 3](#)

HHS POSTS ONLINE BREACH NOTIFICATION FORM

Employer health plans and other "covered entities" are required to notify affected individuals and the Department of Health and Human Services

[Continued on page 6](#)

WARNING: NO JUDICIAL DEFERENCE IF CLAIM DENIAL IS UNTIMELY

We are occasionally reminded that the claims and appeals procedures carefully spelled out in ERISA plans have real meaning. .

[Continued on page 7](#)

UPDATE YOUR ROLLOVER NOTICES FOR 2010

The IRS has finally updated the model "rollover notice" it issued in 2002. In fact, we now have *two* new models. Plan administrators will want to start using these new notices on or before January 1, 2010.

[Continued on page 8](#)

FINAL WARNING: ADOPT THOSE PPA AMENDMENTS BY YEAR-END

Tax-qualified retirement plans must be amended by the end of the 2009 plan year to reflect the mandatory changes enacted as part of the 2006 Pension Protection Act (PPA).

[Continued on page 9](#)

RETIREES PREVAIL IN CLAIM FOR VESTED HEALTH BENEFITS

Unlike pension benefits, ERISA does not ordinarily require any vesting of welfare benefits. Over the years, however, many court decisions have held that an employer can create a vested right to welfare benefits by taking affirmative steps that indicate an intent to provide vested benefits. A recent decision by the Third U. S. Circuit Court of Appeals will make it easier for welfare plan participants to prevail on a claim that welfare benefits have vested.

In this area, the courts have typically started by looking to the written plan document and/or summary plan description (SPD) to determine whether an employer has made an affirmative indication of an intent to provide vested benefits. Until now, the courts have almost uniformly held that a properly worded "reservation of rights" clause in the plan documents is inconsistent with – and in most cases would defeat – a claim of vested welfare benefits. In the recent decision (*In re Unisys Corp. Retiree Medical Benefits ERISA Litigation*), the court concluded that retiree health benefits were vested and could not be changed by the employer, notwithstanding an explicit reservation of rights provision in the SPD.

The plaintiffs in the case were a group of individuals who had retired from employment with the Unisys Corporation in the late 1980's. At that time, Unisys provided free health coverage to retirees aged 65 and older under several different retiree plans. Each of the SPDs for those plans contained a "reservation of rights" clause, under which Unisys retained the right to amend or terminate the plan and the underlying benefits at any time. In 1992, after the plaintiffs had already retired, Unisys discontinued free retiree health coverage and introduced a new plan under which retirees would ultimately have to pay the full cost of coverage.

Plaintiffs brought suit, alleging that Unisys had breached its ERISA fiduciary duty to the plaintiffs because, during various retirement planning meetings, the Unisys human resources staff had (1) misrepresented to the plaintiffs that their retiree health benefits (and the cost of those benefits) were vested and would not change, and (2) failed to disclose to the plaintiffs the existence of the reservation of rights clauses.

The Third Circuit upheld the district court's decision that the plaintiffs were entitled to prospective lifetime benefits based on the terms of the retiree health plans at the time they retired. The Third Circuit specifically rejected Unisys' argument that oral statements about retiree health benefits could not supersede the unambiguous reservation of rights clauses in the SPDs. Instead, the court ruled that Unisys could not rely on the language in the SPDs because the SPDs would not have been provided to a retiree until after he or she had retired and enrolled in the plan.

Notably, in order to find for the plaintiffs in this case, the Third Circuit first had to conclude that Unisys' human resource staff members were acting as *fiduciaries* when they communicated with retirees concerning their health benefits. This may come as a surprise to many plan sponsors, who typically take the position that human resource staff members perform purely "ministerial functions" – necessary for plan administration within a pre-established framework of rules – and thus are not fiduciaries. Having concluded that the staff members *were* fiduciaries, the court then held that a reasonable fiduciary would have foreseen that its conduct would result in the plaintiffs making an important retirement decision based on the mistaken belief that they possessed guaranteed lifetime benefits.

The *Unisys* decision marks an unfavorable trend in the law for employers, and it emphasizes the importance of careful communication with plan participants. In response to this decision, employers should ensure that all documents, materials, and meetings regarding retiree health benefits specifically mention that the employer reserves the right to change or terminate the retiree benefits in the future. Putting such a statement in the SPD, alone, may no longer be enough. Employers should also train benefits staff regarding the importance of disclosing to employees, *before* they retire, the employer's right to terminate or change retiree welfare benefits.

Julia M. Vander Weele, ***Partner***
Spencer Fane Britt & Browne LLP

CONVERTING UNUSED LEAVE TO RETIREMENT PLAN CONTRIBUTIONS

In September of this year, the IRS issued official guidance on how employers may convert unused leave under a bona fide sick leave, vacation leave, or paid-time-off (PTO) program into contributions to a qualified, defined contribution plan (such as a profit sharing or 401(k) plan). Revenue Rulings 2009-31 and 2009-32 provide a virtual "roadmap" for how the value of unused leave (that might otherwise be forfeited each year or paid out in cash on termination of employment) may be used as a basis for making additional employer contributions, or in some cases, employee elective deferrals, to such a plan.

Overview of the Rulings

The concept of converting the value of unused leave time into a contribution to a qualified retirement plan is not entirely new. The IRS has previously issued private letter rulings to several individual plan sponsors (mostly governmental employers, who need not deal with the Tax Code's nondiscrimination rules) with respect to specific leave conversion arrangements.

However, the Obama Administration pushed for the issuance of these revenue rulings – which may be relied upon by *all* plan sponsors – as part of a larger effort to promote retirement savings.

Revenue Ruling 2009-31 addresses the *annual* conversion of unused leave, while Revenue Ruling 2009-32 addresses the conversion of unused leave upon *termination of employment*. Both rulings address two alternative scenarios: (i) where amounts that might otherwise be *forfeited* under the PTO program are instead converted into nonelective employer contributions to a qualified plan, and (ii) where amounts that might otherwise be *paid in cash* under the PTO program are instead converted, at an employee's election, into additional "pre-tax deferrals" to a 401(k) or other salary deferral plan. The ruling that addresses the conversion of unused leave on termination of employment also addresses employees who terminate late in the year, and whose "leave conversion" contributions are therefore made the following year.

<u>Annual Leave Conversion Elections</u>

With respect to annual leave conversions, the ruling contemplates (in one scenario) that an employer has a PTO program that credits up to 240 hours of PTO per year (based on years of service), but does not allow for carryover of unused leave. Instead, any unused leave is simply forfeited at year end. In that scenario, the IRS ruled that the employer may amend its PTO program (and its qualified retirement plan) to provide that the value of any unused PTO (that would otherwise be forfeited) will instead be converted into an employer nonelective contribution to the qualified plan.

Because such an employer contribution would not be the same percentage of pay for all employees, any *non-governmental* plan will be required to perform additional testing (referred to as the "401(a)(4) general nondiscrimination test") to ensure that the leave conversion contributions do not discriminate in favor of highly compensated employees (HCEs). In addition, if the contribution would cause any employee to exceed the Section 415 limit on "annual additions" to a participant's account (which is $49,000 for both 2009 and 2010), the excess must be paid in cash, rather than contributed to the plan.

In the alternative scenario, the PTO plan does allow employees to carry over a limited number of PTO hours, but provides that any unused hours in excess of the carryover limit will be paid to the employee in cash, during February of the following year. In this scenario, the IRS ruled that the employer may allow employees to elect, no later than December 31, to convert all or a portion of the unused leave that cannot be carried over (the portion that would otherwise be paid out in cash in the following year) into an "employee pre-tax deferral" to the plan. Because the cash would not have been payable until the following year, any amount the employee elects to convert will also count as a deferral for the following year.

Thus, if at the end of 2009, an employee has 100 hours of unused leave, but the PTO policy allows only 40 hours to be carried over (and provides for the other 60 to be "cashed out" in the following year), the employee may elect to convert all or a portion of the value of that 60 hours into an "employee contribution" to the plan. This amount will count against the $16,500 limit on the employee's deferrals for the 2010 calendar year.

Leave Conversion Elections on Termination of Employment

The second ruling addresses four different scenarios involving the conversion of unused leave on termination of employment. In the first scenario, the PTO program provides for unused PTO to be paid out in cash within 60 days of termination of employment. The IRS ruled that, in this situation, the employer could amend the PTO plan (and the qualified plan) to provide that, instead of paying out the unused PTO in cash, the value of the unused PTO would be contributed to the plan as an employer non-elective contribution. The only portion to be paid in cash would be the amount, if any, that would cause the plan to exceed the $49,000 limit on annual additions.

Alternatively, the employer could amend the PTO plan (and the qualified plan) to provide that employees could elect, prior to termination, to convert a portion of their leave cash-out amount into an employee pre-tax contribution to the plan. This contribution would count against the employee's $16,500 limit on elective deferrals for the year in which it is credited to the qualified plan.

The final two scenarios involve a situation in which an employee terminates late in the year, and the leave cash-out (and consequently the conversion to employer or employee contributions) occurs in the following year, when the participant has no other compensation. Ordinarily, this could pose a problem because the alternative Section 415 limit on annual additions is 100% of a participant's "Compensation." However, so long as the employer has amended the plan, as permitted under the final Section 415 regulations, to include in the definition of "Compensation" any leave cash-outs that are paid within 2 1/2 months after termination of employment (or by the end of the plan year of termination, if later), the leave conversion contributions will not cause the Section 415 limit to be exceeded, even though the participant receives no other compensation from the employer in that year.

Proceed With Caution

Plan sponsors contemplating any type of leave conversion arrangement should proceed with caution, as there are a number of potential pitfalls. First, the employer must make sure that the PTO program qualifies as a "bona fide" sick, vacation or other leave arrangement, and is therefore exempt from the constraints imposed by Code Section 409A. The PTO program should also not include any cash-out or "buy-back" provisions that would implicate the IRS rules regarding constructive receipt.

In addition, sponsors should make sure that any leave conversion contributions do not cause their retirement plans to lose their tax-qualified status. This could happen if the contributions cause a participant's annual additions to exceed the Section 415 limit. Any private (i.e., non-governmental) employer will also want to ensure that nonelective leave conversion contributions do not cause the plan to fail the Section 401(a)(4) nondiscrimination test. This may effectively require that HCEs be excluded from the leave conversion feature. Finally, an employer will want to make sure that any "elective" contributions are properly counted against the $16,500 limit on elective deferrals for the appropriate year, and that any deferral elections are made in a timely manner.

For all of these reasons, we strongly advise that sponsors work with experienced benefits counsel when designing a program to convert unused leave into retirement plan contributions.

Robert A. Browning, *Partner*
Spencer Fane Britt & Browne LLP

HHS POSTS ONLINE BREACH NOTIFICATION FORM

As explained in our March 2009 and September 2009 articles, employer health plans and other "covered entities" are required to notify affected individuals and the Department of Health and Human Services (HHS) when they breach certain of the privacy requirements imposed by the Health Insurance Portability and Accountability Act (HIPAA). HHS has now posted on its website an online form by which such breaches may be reported to HHS.

The online form differentiates between breaches affecting fewer than 500 individuals and those affecting 500 or more. This is because breaches affecting fewer than 500 individuals need not be reported to HHS until 60 days after the end of the calendar year in which the breach occurred, whereas larger breaches must be reported within 60 days after discovery of the breach (i.e., the same deadline that applies to notifying affected individuals).

The online form asks for a substantial amount of information concerning each breach. For instance, a plan should be prepared to describe the type and location of the breach, the type of information that was disclosed (demographic, financial, or clinical), the safeguards that were in place to prevent the breach, actions taken to notify the affected individuals and media of the breach, and any subsequent mitigation or corrective actions.

Business associates of covered entities will become subject to this breach notification requirements as of February 17, 2010. Their obligation, however, is simply to notify the covered entity of the breach – including the names of the individuals who were affected by it. It is then up to the plan or other covered entity to fill out the online form. Plans will therefore want to ensure that all of their business associates are aware of this breach notification requirement – and have committed themselves to complying with the reporting rules.

Kenneth A Mason, *Partner*
Spencer Fane Britt & Browne LLP

WARNING: NO JUDICIAL DEFERENCE IF CLAIM DENIAL IS UNTIMELY

We are occasionally reminded that the claims and appeals procedures carefully spelled out in ERISA plans have real meaning. Although the regulatory deadlines within which plan fiduciaries must render decisions on benefit claims and appeals may appear arbitrary – and although many plan administrators treat them as mere "guidelines" – the failure to abide by those deadlines can have disastrous consequences in court. A recent decision by the 10th U.S. Circuit Court of Appeals illustrates that those deadlines do have teeth. (*Rasenack v. AIG Life Insurance Co.*)

Mr. Rasenack sued the administrator of his employer's disability plan under ERISA, challenging the administrator's denial of his claim for benefits. The claim hinged on an interpretation of a disputed term in the disability plan. The trial court ruled in favor of the administrator, based on an application of the "arbitrary and capricious" standard of review. The 10th Circuit reversed.

The administrator had failed to timely process Mr. Rasenack's claim and administrative appeal, finally issuing a decision on the appeal only after Mr. Rasenack had filed suit. Although the terms of the plan vested the administrator with discretionary authority, which generally entitles an administrator to a deferential standard of judicial review under the familiar rule of *Firestone v. Bruch*, the 10th Circuit held that an administrator *loses* this entitlement to deferential review when its delay in deciding a claim results in the claim being "deemed denied." The court concluded that "not only must the administrator be given discretion by the plan, but the administrator's decision in a given case must be a valid exercise of that discretion." In this instance, because the administrator failed to render a decision on the administrative appeal, the administrator's interpretation of the disputed term was not entitled to deference.

Plan administrators would be well advised to consider carefully the lesson imparted by the 10th Circuit in this case, and to treat claims and appeals deadlines as more than mere guidelines.

Gregory L. Ash, *Partner*
Spencer Fane Britt & Browne LLP

UPDATE YOUR ROLLOVER NOTICES FOR 2010

The IRS has finally updated the model "rollover notice" it issued in 2002. In fact, we now have *two* new models. Plan administrators will want to start using these new notices on or before January 1, 2010.

When Congress created the "direct rollover" concept in 1993, it also mandated that each recipient of a rollover-eligible distribution receive an explanation of the options available to that recipient, including the tax treatment of each option. The IRS issued a "model" of such a rollover notice in 2002, but that model was soon rendered obsolete by a series of statutory changes broadening the rollover rules.

For instance, the direct rollover option was made available to more types of plans (including Section 403(b) tax-sheltered annuities, governmental Section 457(b) plans, and Roth IRAs), additional recipients (including non-spousal beneficiaries), and more types of distributions (including Roth and other after-tax amounts).

The IRS has finally rectified this problem by issuing updated rollover notices. One such notice applies only to distributions made from Roth accounts, while the other applies to all other types of distributions. According to the IRS, any recipient of a distribution from both a Roth *and* a non-Roth account should receive *both* notices.

These new notices are not just updated. They have also been simplified. Moreover, they are organized in a way that should make it fairly easy to delete language that does not apply to a particular plan, recipient, or distribution. For instance, plan administrators might consider deleting the portions of the notice dealing with after-tax amounts, employer stock, governmental 457(b) plans, outstanding participant loans, nonresident aliens, and/or non-spousal beneficiaries. Deleting such language (where appropriate to do so) can substantially shorten the rollover notice.

As of January 1, 2010, these new notices will replace the 2002 model as the "safe-harbor" method of satisfying the rollover notice requirement. Most plan administrators will therefore want to move to these new notices by no later than that date. Both of these model notices are posted on the IRS website.

Kenneth A. Mason, *Partner*
Spencer Fane Britt & Browne LLP

FINAL WARNING: ADOPT THOSE PPA AMENDMENTS BY YEAR-END

As reported in our August 2009 article, tax-qualified retirement plans must be amended by the end of the 2009 plan year to reflect the mandatory changes enacted as part of the 2006 Pension Protection Act (PPA). For calendar-year plans, this PPA amendment deadline is December 31, 2009. (Governmental plans have an additional two years, and certain collectively bargained plans may enjoy an extension, as well.)

Because the consequences of failing to meet this amendment deadline could be quite severe, plan sponsors should take immediate action to verify that all of the necessary amendments have been adopted. As further explained below, Spencer Fane's Employee Benefits Group is ready to assist in this process.

Mandatory PPA Changes

Although the more significant PPA changes affect defined benefit plans, several of the changes will also apply to defined contribution plans. For example, virtually all defined *benefit* plans must be amended for the following PPA changes:

- Modified assumptions for converting annuities into lump-sum payments (even small, lump-sum cashouts)
- Benefit restrictions based on a plan's funding status
- Expansion of the direct rollover rules (e.g., allowing such rollovers to Roth IRAs, of after-tax amounts, and -- as of January 1, 2010 -- by non-spousal beneficiaries)
- Addition of a "qualified optional survivor annuity" (typically, a 75% joint and survivor annuity)

Depending on the type of plan, defined *contribution* plans may need to be amended to reflect the following PPA provisions:

- Faster vesting of non-matching employer contributions
- Expanded diversification rights for amounts invested in publicly traded stock of a sponsoring employer
- Modified treatment of "gap period income" in connection with corrective refunds
- Expanded direct rollover rules
- Addition of a qualified optional survivor annuity (for plans offering annuity distribution options)

Optional PPA Provisions

In addition to these *mandatory* changes, the PPA contained a number of provisions that plans may *choose* to adopt. These optional PPA provisions include the following:

- In-service distributions to facilitate “phased retirement”
- An expanded notice and election period for plan distributions
- Various types of automatic contribution arrangements
- Expanded hardship withdrawal opportunities
- Acceptance of additional types of rollover contributions

A plan that chose to implement any of these optional PPA provisions during 2009 must *also* be amended by the end of this year.

Discretionary Plan Amendments

Finally -- and entirely unrelated to these PPA changes -- current IRS guidance requires that any “discretionary” change in a plan’s operations be reflected in a plan amendment by the last day of the plan year in which that change was implemented. An example of such a discretionary change might be the addition of distribution option. Under this rule, any calendar-year plan implementing a discretionary change during 2009 must be amended by December 31, 2009, to reflect that change.

Consequences of Failing to Amend

The consequences of missing any of these amendment deadlines could be quite severe. The plan would lose its tax-qualified status. And, unfortunately, this is *not* the type of disqualifying defect that can be corrected under the IRS’s Self-Correction Program (SCP). Rather, the plan’s sponsor would have to participate in the *Voluntary* Correction Program (VCP). This would require both a submission to the IRS and the payment of a compliance fee.

We therefore strongly recommend that retirement plan sponsors review the terms of their plans to ensure that all PPA-related and discretionary changes have been reflected in appropriate plan amendments. Due to the number and variety of PPA changes, this will not be a simple task.

As a service to our clients (both current and new), Spencer Fane’s Employee Benefits Group will charge a flat fee of only $500 to review any qualified retirement plan to determine whether additional changes must be adopted by the end of the current plan year to document any of the mandatory PPA provisions. If we receive sufficient information concerning optional or discretionary changes implemented during 2009, our review will cover those types of amendments, as well. If this review confirms that all required amendments have already been adopted, the plan sponsor will enjoy relatively inexpensive peace of mind. If our review determines that additional amendments are needed, we will draft those amendments by the applicable deadline for our standard hourly fee.

Other Amendment Deadlines

Sponsors should also be aware of two other amendment deadlines of note. First, the deadline has already passed for virtually all qualified plans to adopt amendments needed to comply with final regulations issued under Section 415 of the Tax Code. Any sponsor that has missed this deadline should nonetheless adopt an appropriate Section 415 amendment in the near term. The failure to meet this amendment deadline may be corrected under VCP for a fairly minimal compliance fee of $375.

Second, as explained in our February 2009 article, qualified plans falling within "Cycle D" of the IRS's determination letter program must be amended and restated -- and a determination letter application filed with the IRS -- by January 31, 2010. This deadline is entirely unrelated to the plan year on which a plan operates. In general, a plan falls within Cycle D if the sponsoring employer's tax identification number ends with either "4" or "9." The changes that must be incorporated into a Cycle D plan are even more extensive than the PPA changes summarized above. Accordingly, the sponsor of any Cycle D plan that has not already begun this review and amendment process should do so without further delay.

Kenneth A. Mason, ***Partner***
Spencer Fane Britt & Browne LLP

Garner Insurance Services
630 N. Rosemead Blvd., Suite 300, Pasadena, CA 91107
(626) 351-2300 / (626) 371-0447 Fax
www.garnerbenefits.com